

International  
Credit Analysis

# International Finance Facility for Immunisation (IFFIm)

## Ratings

Security Class	Current Ratings
<b>Foreign Currency</b>	
Long-Term IDR	AAA
Short-Term IDR	F1+
<b>Senior Unsecured</b>	
Long-Term (Global Debt Issuance Programme)	AAA

## Outlook

Foreign Long-Term IDR	Stable
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## Related Research

- [International Finance Facility For Immunisation](#)

## Rating Rationale

- IFFIm's 'AAA' rating remains supported by strong donor commitment to IFFIm and its role in supporting immunisation and vaccine procurement programmes through the Global Alliance for Vaccines and Immunisation (GAVI). IFFIm funds these programmes by issuing bonds in the capital markets backed by grant commitments from the governments of the UK ('AAA'), France ('AAA'), Italy ('AA-'), Spain ('AAA'), Sweden ('AAA') and Norway ('AAA'). Sovereign donors and IFFIm consider the grant agreements to be legally binding and, in Fitch Ratings' opinion, repudiation of these commitments would impose severe reputational damage. IFFIm's immunisation and vaccine procurement programmes have enjoyed strong take-up and support among the development community.
- In a clear indication of ongoing support, the French government signed a second grant agreement in December 2007 for EUR867m over 20 years. IFFIm's total resource base (not discounted) consequently increased to the equivalent of USD5.3bn from USD4bn. South Africa ('BBB+') also committed USD20m over 20 years in March 2007 although Fitch does not recognise this as part of IFFIm's resource base for the purpose of assessing its 'AAA' status because of the lower credit quality of the South African sovereign. With the contribution of the French government rising to 33% of IFFIm's total resource base, Fitch has now linked its assessment of IFFIm's credit rating directly to that of the Republic of France, in addition to the existing credit linkage to the UK's sovereign rating. The unlikely event of a downgrade of the UK or France would prompt a review of IFFIm's ratings.
- IFFIm has exposure to vaccine recipient countries' sovereign credit risk as donor grant payments can be reduced if sovereigns in the pool of 70 eligible recipient countries enter protracted arrears with the IMF. In order to reflect this Fitch has assigned a maximum "gearing ratio" – defined as IFFIm's net financial liabilities as a proportion of the net present value of IFFIm's resource base – of 73%, consistent with IFFIm's 'AAA' rating. There have been no changes in the number of recipient countries in protracted arrears to the IMF (four) and several countries have seen sovereign rating upgrades since Fitch's September 2006 report on IFFIm. However, the weighted average rating of the recipient country pool (allowing for some credit uplift to reflect the IMF's preferred creditor status) remains at 'BB' and Fitch has not revised its maximum gearing ratio.
- The realised gearing ratio is currently well below the maximum at around 35%, leaving sizeable headroom for further increases in IFFIm's net debt. IFFIm expects to issue bonds under its global debt issuance programme in the Japanese retail market this month, denominated in South African rand.
- IFFIm's liquidity, credit and market risks are being managed effectively by the World Bank ('AAA'), IFFIm's designated treasury manager.

## Key Rating Drivers

- Sovereign donors' commitment to IFFIm
- Recipient countries' sovereign credit ratings and payment arrears to the IMF
- IFFIm's realised gearing ratio relative to 'AAA' limit
- Sovereign ratings of largest IFFIm donors, UK and France

This Credit Analysis sets out key developments in IFFIm's credit profile following the release of Fitch's first Credit Analysis on IFFIm in September 2006. The following sections discuss IFFIm's resources and operations, financial accounts for 2006 and risk management.

### Resources and Operations

IFFIm's resource base expanded significantly on 7 December 2007, when a second set of grant pledges from the French government worth EUR867m over 20 years came into effect. This takes the combined French contribution to EUR1240m, equivalent to USD1,722m (using exchange rates on the dates the two grant agreements became effective). IFFIm's total cumulative grant pledges over the next 20 years in absolute terms (not discounted) have increased to USD5,233m from USD3,986m. The second French grant agreement was effected through the Ministère de l'Économie, des Finances et de l'Emploi and signed by French Finance Minister Christine Lagarde, distinct from the first agreement, which was enacted through Agence Française de Développement.

The additional French commitment increases France's share of IFFIm's total resource base to 33% from 12%. The shares of the UK and Italy have declined from 65% to 50% and 15% to 11%, respectively. While the UK is still the largest donor, Fitch judges the increased French share of IFFIm's resources to be large enough to justify linking IFFIm's credit rating directly to France's sovereign rating in addition to the UK sovereign rating (to which it is already credit linked). In the unlikely event that France's rating was downgraded from 'AAA', this would prompt a review of IFFIm's rating and would, all else equal, likely result in a downgrade. In such circumstances IFFIm would be unable, in Fitch's opinion, to reduce its gearing ratio sufficiently to take account of the lower credit quality of the French commitments.

#### IFFIm's Resource Base

Cumulative grants 2006-2026	Local currency, m	USD equivalent <sup>a</sup>
UK (GBP)	1,380	2,601
Italy (EUR)	473	603
Spain (EUR)	190	242
Sweden (SKR)	276	38
Norway (USD)	n.a.	27
France initial (EUR)	373	475
France second agreement (EUR)	867	1,247
<b>Total (USD)</b>		<b>5,233</b>
<i>Memo</i>		
South Africa (USD)	n.a.	20

<sup>a</sup> Calculated using exchange rate on 2 October 2006 except for second French contribution on 17 December 2007  
Source: IFFIm Global Debt Issuance Programme, Fitch

South Africa also signed a grant agreement in March 2007 for a total commitment of USD20m over 20 years. However, for the purpose of assessing IFFIm's 'AAA' status, Fitch does not include these commitments as part of IFFIm's resource base until actual cash payments are received, given South Africa's lower sovereign credit quality. The government of Brazil ('BB+') has also signalled its intention to contribute USD20m but this has not yet been finalised.

IFFIm expects to issue a further USD200m-500m of bonds in 2008, including in Europe and the Japanese uridashi market. Specifically, IFFIm has announced plans to issue notes targeting Japanese retail investors. The notes are expected to be launched this month and will be denominated in South African rand. They will be issued under IFFIm's global debt issuance programme, rated 'AAA' by Fitch.

As at end-December 2007 IFFIm had disbursed USD953m to the GAVI Fund Affiliate for immunisation and vaccine procurement. This included USD181m for securing supplies of pentavalent "five-in-one" vaccine; USD114m for health system strengthening programmes; USD139m for measles campaigns; USD191m for polio

eradication and vaccine stockpiles; USD57m for a yellow fever vaccine stockpile; and USD53m for maternal and neonatal tetanus. As at October 2007 some 41 eligible recipient countries had received payments. An important part of IFFIm's activities has been to provide guaranteed long-term funding to enhance incentives for pharmaceutical companies to produce vaccine stockpiles.

### **Financial Accounts**

The appendix tables show IFFIm's accounts for 2006, produced by IFFIm's trustees in accordance with UK GAAP and audited by Deloitte & Touche in October 2007. They are compiled on an accruals basis with the exception that financial assets and liabilities are measured at fair value.

The simplest way to understand IFFIm's financing activities is through a cash flow analysis. In 2006 IFFIm issued a USD1bn bond in the international capital markets and also received USD20m in scheduled grant payments from some of its donors, including Italy, Spain, Sweden and Norway (the first scheduled donor payments for the UK and France were in 2007).<sup>1</sup> Some USD525m of the proceeds from the bond issue were advanced for immunisation and vaccination procurement programmes, with the remaining USD499m invested in liquid assets managed by the World Bank in a pooled portfolio along with other assets of the GAVI Fund Affiliate (GFA) and other trusts. These investments generated income of USD3.6m in 2006. As at end-2006 a further USD336m of programmes had been approved but not drawn, appearing as grants payable in IFFIm's balance sheet.

IFFIm's income and expenditure accounts reflect in full pledged grants to be paid over the next 20 years as 2006 contribution revenue. In absolute terms these pledges were equivalent to USD3,976m using the prevailing market exchange rate on 2 October 2006, when the grant agreements were activated. However, the trustees have made two sets of "fair value" adjustments to this amount. Firstly grants scheduled to be paid 12 months or more after the initial signing date have been adjusted to net present value (NPV) using country-specific "risk-free" (i.e. long-term sovereign) interest rates – this leads to a downward adjustment of USD1,169m. In addition the trustees have applied a haircut to the pledges to allow for the estimated percentage of recipient countries falling into protracted arrears to the IMF under the terms of the High Level Financing Condition (HLFC). This adjustment is equivalent to just under 18% or USD699m. In reality the HLFC adjustment in 2006 was just 4% (reflecting protracted arrears to the IMF by Somalia, Liberia, Sudan and Zimbabwe only) and this difference resulted in a realised gain of USD3m on donor payments made in 2006.

Operating expenses include approved programme expenditure, administrative and financial management support (including legal and audit fees) and trustees' travel expenses. IFFIm has no employees and trustees are not remunerated. Interest payments and other charges include bond issuance costs and net fair-value losses on pledges and pledge swaps and on bonds and bond swaps.

Net fair-value losses in the income and expenditure statement were USD18m in 2006 and related partly to IFFIm's transactions to hedge market risk. These involved swaps of all grant streams into a zero-coupon USD floating-rate three-month LIBOR basis and a swap of IFFIm's fixed-rate bond obligations into USD three-month LIBOR floating-rate liabilities. Net fair-value losses on pledges and pledge swaps were USD10m, comprising an unrealised fair-value gain of USD59m on pledges due to exchange rate movements (primarily the appreciation of the GBP against the USD in late 2006) and a net fair-value loss of USD70m on currency swaps. The difference in these two figures reflects the fact that the unrealised fair-value gains were calculated on the basis of pledges adjusted for the estimated percentage of

<sup>1</sup> Grants received were 96% of the scheduled amount reflecting the four recipient countries in arrears to the IMF in 2006.

recipient countries falling into protracted arrears to the IMF (i.e. the currency gains were calculated on a base of 82% of the pledges) whereas the swap transactions assumed that the actual 2006 recipient country default rate remained at 4%, and hence the losses related to the pledge swap were based on 96% of the pledged amounts. In addition there were USD8m of fair-value losses on bond liabilities related to market price movements.

IFFIm's balance sheet shows assets of USD2,649m at end-2006, comprising pledges receivable and investment funds in trust. The former is based on contribution revenue, as included in the income and expenditure account (net of donor payments received in 2006), plus the USD59m fair-value adjustment reflecting currency shifts, as described above. Liabilities include bonds payable (at market value), grants payable to GFA, and other short-term liabilities, comprising mainly amounts due for currency and interest rate swaps. Net debt – bonds payable minus investment funds – was USD508m at end-2006 and net financial obligations including payables due on derivative contracts were USD578m.

### Risk Management

IFFIm faces market, liquidity and credit risks. These risks are being well managed. Market risk includes exchange rate risk affecting the USD values of its donor pledge income streams, interest rate risk on its debt obligations, and market risk in IFFIm's investment portfolio. Exchange rate and interest rate risks on IFFIm's donor incomes and obligations are hedged through the use of derivatives, as discussed above. These effectively translate all IFFIm's future donor pledge cash flows and capital market liabilities to a USD three-month LIBOR floating-rate basis, matching the interest rate and exchange rate exposure of IFFIm's assets and liabilities. IFFIm's investments are managed by the World Bank with investment principles analogous to those used in the management of the reserve assets of the International Bank for Reconstruction & Development (IBRD). IFFIm's liquid assets are invested in high-grade fixed-income instruments with interest rate sensitivity matching IFFIm's liabilities. According to the World Bank the investment pool has no exposure to asset-backed securities with US subprime mortgage exposure.

Liquidity risk arises due to differences in timing between IFFIm's donor pledge income stream and its debt service obligations. The appointment of the World Bank as treasury manager gives a high degree of comfort that liquidity risk will be managed effectively. Furthermore IFFIm follows a liquidity policy whereby liquid assets are to be maintained at a level equal to cumulated contractual debt service payments over the next 12 months. At end-2006 liquid assets were USD499m compared with debt service obligations of USD40m. By means of illustration, the liquidity policy would imply that IFFIm would need to refinance its five-year bond issued in 2006 at least one year ahead of its maturity date in November 2011 and maintain the proceeds as liquid assets until the original bond was repaid.

Credit risk relates to the risk of donor non-payment of grant pledges, reductions to payments due to breaches of the HLFC, counterparty risk on derivative contracts and default risk on its investment portfolio. Risk of donor non-payment largely reflects the sovereign credit risk of donor governments themselves. All IFFIm's donors are rated 'AAA' with the exception of Italy, which was downgraded to 'AA-' from 'AA' in October 2006. However, Fitch's specified maximum gearing ratio of 73% incorporates an adjustment for the risk of Italian donor default, which is not tied directly to movements in Italy's credit rating.<sup>2</sup> Moreover the share of Italy's donation to IFFIm has fallen. Fitch's discussions with the World Bank revealed effective procedures for ensuring timely payments of donor grants on due instalment dates. Political support for IFFIm remains strong. Furthermore Fitch judges IFFIm's management to be sufficiently independent to publicise any

<sup>2</sup> See "International Finance Facility for Immunisation", published on 5 September 2006 and available on [www.fitchresearch.com](http://www.fitchresearch.com).

potential aberration by donors from their commitments, however unlikely. This would amplify the high reputational costs to donors from non-payment of obligations viewed by donors and IFFIm to be legally binding.

Credit risk also emanates from recipient countries entering protracted arrears with the IMF. Fitch has reflected this in the maximum gearing ratio of 73%, consistent with IFFIm's 'AAA' rating. Since the 2006 analysis the sovereign ratings of a number of recipient countries have been upgraded, including those of Azerbaijan, Indonesia and Malawi. Liberia has also made important progress towards normalising its relations with official creditors but remains in protracted arrears to the IMF. The weighted average sovereign rating of the recipient country pool has risen to 'B' from 'B-'. However, the weighted average rating including credit uplift to reflect the IMF's "preferred creditor status" remains at 'BB' and Fitch has not amended its maximum gearing ratio of 73%. Fitch will review the maximum gearing ratio periodically as recipient countries' sovereign credit risk develops. In addition the agency's ongoing review of its methodology for assessing credit risk in collateralised debt obligations (CDOs) – which was drawn upon to help inform the assessment of the gearing ratio limit – could have some impact on the maximum gearing ratio.

At this stage the actual gearing ratio remains well below the prudential limit. IFFIm reported a realised gearing ratio of 20% at end-2006, which had risen to 36% by Q307 as vaccination programmes' expenditure rose and IFFIm's financial assets were drawn down accordingly. The calculation for end-2006 is shown in the table below. Immunisation and vaccine procurement programme expenditure rose by a further USD428m in 2007 and, taking into account the recently finalised second French grant agreement, the gearing ratio was around 35% at end-2007.

Counterparty credit risk in derivative transactions is mitigated by the role of the IBRD ('AAA') as IFFIm's counterparty in these contracts. Credit risk in IFFIm's investment portfolio is mitigated by adherence to minimum rating guidelines for IFFIm's liquid assets, including 'A-' for money market instruments, 'AA-' for government or agency obligations, and 'AAA' for corporate bonds and asset-backed securities.

### Gearing Ratio Calculation

31 December 2006	USDm
Total grant pledges in USD equivalent	3,976
Net present value adjustment for grants >1 yr	-1,169
Less donor payments received in 2006	-20
Less adjustment for swaps	-10
Adjusted NPV	2,777
Net financial obligations	578
Net financial obligations/adjusted NPV (%)	20.8

Source: IFFIm Report of the Trustees and Financial Statements, Fitch

## Appendix

### Cash Flows

2006

Inflows		Outflows	
	USDm		USDm
Bond issue	999	Grants made	525
Donor payments	20	Investments	499
Investment income	4		
<b>Total</b>	<b>1,024</b>	<b>Total</b>	<b>1,024</b>

Source: IFFIm - Report of Trustees and Financial Statements 31 December 2006

### Income and Expenditure Account

31 Dec 2006

USDbn

Contribution revenue	2,110
Operating expenses	865
o/w grant payments	861
Operating income	1
Operating profit	1,246
Investment income	4
Interest payable and other charges	20
Surplus	1,230

Source: IFFIm - Report of Trustees and Financial Statements 31 December 2006

### Balance Sheet

31 Dec 2006

Assets		Liabilities	
	USDm		USDm
Donor pledges	2,149	Bondholders	1,007
Funds in trust	499	Other short term	75
Other	1	Grants payable	336
<b>Total</b>	<b>2,649</b>	<b>Total</b>	<b>1,419</b>
		Net assets	1,230
		Liabilities +net assets	2,649
		<i>Memo items:</i>	
		Net debt	508
		Net financial obligations	578

Source: IFFIm - Report of Trustees and Financial Statements 31 December 2006, Fitch

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